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641587—62

In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 916

PERCY C. AND MARGARET A. MAGNUS, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinions of the district court (R. 18a–19a, 21a) [1] are reported at 196 F. Supp. 127. The opinion of the court of appeals (Pet. 20–25) is reported at 299 F. 2d 335.

JURISDICTION

The order of the court of appeals was entered on February 13, 1962. (Pet. 26.) A petition for rehearing was denied on March 8, 1962. (Pet. 36.) A petition for rehearing *en banc* was denied on March 20, 1962. (Pet. 37.) The petition for a writ of certio-

[1] References designated "R." are to the appendix to petitioners' brief in the court of appeals.

rari was filed on April 28, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the district court properly denied taxpayers' motion to quash Internal Revenue summonses, issued during an investigation of their income tax liabilities, which called for the testimony and records of third parties not previously sought.

STATUTES INVOLVED

Internal Revenue Code of 1954:

SECTION 7602. EXAMINATION OF BOOKS AND WITNESSES.

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before

the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

(26 U.S.C. 1958 ed., Section 7602.)

SECTION 7605. TIME AND PLACE OF EXAMINATION.

* * * * *

(b) *Restrictions on Examination of Taxpayer*—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

(26 U.S.C. 1958 ed., Section 7605.)

STATEMENT

In June 1958 the Internal Revenue Service began an investigation of the tax liabilities of petitioners, Percy C. and Margaret A. Magnus. Internal Revenue Agent Victor Blatt was initially assigned to the matter and remained assigned at the time of the proceedings here involved. At separate times the following other Special Agents were assigned to work jointly with him: Victor Biskup, John J. McLoughlin, Joseph H. Gillespie and George Alderman. (R. 14a.)

As of the time of the proceedings below, the investigation had revealed that, prior to the examination instituted by Agent Blatt, petitioners had never filed income tax returns or paid taxes they owed for the years 1948 through 1957. They had failed to file returns "reflecting approximately $1,000,000 of personal income" during those years. (R. 15a.)

On June 19, 1961, two Internal Revenue Service summonses were issued by Special Agent Alderman. One of these summonses, addressed to Magnus, Mabee & Reynard, Inc. (a corporation of which petitioner Percy C. Magnus was the president, a director and a stockholder), called for testimony by corporate officials relating to the liability of petitioners for the period 1948–1957, inclusive, and for the production of certain designated corporate books and records. The second summons, calling for testimony and the production of records relating to petitioners' liabilities for the same period, was addressed to Hurdman & Cranstoun (certified public accountants whose services were used by petitioner Percy C. Magnus and by the corporation). (R. 4a, 9a–10a, 11a–12a.)

On June 28, 1961, Percy C. Magnus petitioned the district court for an order quashing the summonses. The petition, which was in the form of an affidavit, alleged that in 1959 petitioner was the subject of an investigation conducted by Special Agent Biskup (par. 3); that the latter had "found at least preliminarily that the evidence did not support a possible charge of willfulness" (a finding "presumed" to be "embodied in a written report") (par. 5); that in the summer of 1960 Special Agent Gillespie conducted "a new investiga-

tion relating to the same years and having the same subject matter" (par. 6); that "The investigation was once again terminated", Gillespie having "made a finding [presumably "embodied * * * in a written report"] that there was an absence of willfulness", with consequent referral of the matter "back to the Audit Division of the Service" (par. 7); and that "The matter again appeared to be finally closed until May 24, 1961 when I was advised through my lawyer that a third Special Agent, George Alderman," came into the matter (par. 8). (R. 4a–6a.)

In response to the petition, the government submitted an affidavit of Special Agent Alderman which stated (R. 14a–15a):

* * * * *

> 3. At no time since June, 1958, has the investigation into the affairs of the above-named taxpayers been concluded. At no time has any formal notice been sent to the taxpayers of the termination of this investigation.
>
> 4. The procedures of the Internal Revenue Service in all income tax examinations of this nature require that at the conclusion of said examination, a report be furnished to the taxpayer wherein he is advised that the examination has resulted in a deficiency and additional taxes are due. At the same time, the taxpayer is sent a Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment (Internal Revenue Form 870). If the taxpayer accepts the proposed tax changes, he signs and returns the waiver, Form 870. No such revenue agent's

report or waiver, Form 870, has been sent Percy C. and Margaret A. Magnus.

* * * * *

The district court denied the motion to quash the summonses. The court ruled that petitioners had not attempted "to show that the investigation that is going on is unnecessary" (R. 19a) and that no hearing was required since "no issue [in that respect] is tendered". (R. 21a.)[2] The court of appeals affirmed. It held that the prohibition in Section 7605(b) of subjecting taxpayers to "unnecessary examination or investigations" was inapplicable to an examination of third parties and that petitioners had no standing to quash summonses which called neither for their appearance or examination nor for production of their books. (R. 23, 26.)

ARGUMENT

Section 7602 of the Internal Revenue Code of 1954 (*supra*, p. 2) gives the Internal Revenue Service broad authority to examine books and records, and to compel testimony, relating to tax liability. Section 7605(b) provides, however, that no taxpayer "shall be subjected to unnecessary examination and investigations." Petitioners contend that since several agents

[2] Presumably addressing itself to petitioners' erroneous conception that Section 7605(b) of the 1954 Code entitled them to notification in writing that an additional inspection was necessary, the district court correctly pointed out (1) that the statute required notice to be given only where more than one inspection of a *taxpayer's books of account* are made for each taxable year and (2) that the summonses here involved sought an examination of third party, not petitioners', books and records (R. 18a–19a).

had examined them and their books and records over a three-year period, the subsequent attempt by the government to examine the books and records, and to take the testimony of, third persons not previously examined, constituted an "unnecessary" examination or investigation prohibited by Section 7605(b). Both courts below correctly rejected this contention and refused to quash the administrative summonses directed to the third persons. The proposed examination of such persons and their books and records was not "unnecessary" but, on the contrary, was an appropriate step in continuing the existing investigation of petitioners' apparent failure to file income tax returns covering substantial tax deficiencies over a ten-year period. There is no conflict of decisions, and further review is unwarranted.

1. The summonses in question, issued on June 19, 1961, sought for the first time the testimony and records of third parties in connection with an investigation of petitioners' tax liabilities which had begun in June, 1958. Petitioners do not dispute Special Agent Alderman's assertion under oath that they failed, prior to the inception of the investigation, to file returns for the period 1948 to 1957 which should have reported "approximately $1,000,000 of personal income". (R. 15a.) Nor do petitioners contend that the testimony and records sought were not germane to the investigation of petitioners' tax liabilities. Their contention is that the investigation of those liabilities, although initially authorized by Section 7602 of the Internal Revenue Code of 1954, *supra*, was in fact concluded by the time the summonses in ques-

tion were issued, and that therefore any subsequent examination of the hitherto uninspected third party records and any questioning of the hitherto uninterrogated officials of the corporation and accounting firm were "unnecessary."

The basic fallacy in petitioners' contention, as the district court observed (R. 19a, 21a), is that there is no necessary connection between an allegation that the investigation had concluded and a conclusion that a subsequent investigation is "unnecessary". Even if it were assumed that the investigation of petitioners' tax liabilities had been concluded at the time the summonses to the third parties were issued, it would not follow that a re-investigation based on hitherto unexamined witnesses and records would be "unnecessary" in the Section 7605(b) sense. On the contrary, such new material may make a further investigation particularly necessary.

Moreover, petitioners' moving papers were inadequate to raise any issue as to whether the investigation of petitioners' tax liabilities had in fact been terminated. The affidavit of petitioner Percy C. Magnus (R. 4a–8a) does set forth the fact of successive participation in the investigation by three different agents, and alleges that these examinations—made without the records or testimony sought by the instant summonses—failed to establish the element of willfulness in petitioners' violations of the tax laws during the years under investigation. But a single

investigation is comprised of many steps and may involve the participation of several agents. As the court of appeals aptly pointed out (Pet. 24): "An investigation * * * often requires a long period of time. There may be many ramifications which lead into many areas. Each new clue investigated is not a new investigation in a Section 7605(b) sense." To hold otherwise would be to create an "intolerable situation * * * which would seriously impair any effective investigation"—a situation in which a taxpayer would be "allowed, by injunction or motion to vacate, to compel IRS to disclose information already obtained and what it hoped to secure through its various summonses". (Pet. 23.)

Finally, on the record in this case petitioners had no standing to quash the summonses. The court below correctly held that the restrictions of Section 7605(b) should not be construed to permit taxpayers, whose personal testimony and records are not sought, to question the otherwise ostensibly proper interrogation of third parties and the inspection of third party records, especially where, as here, such interrogation and inspection had not previously been undertaken. As the court of appeals noted (Pet. 24), third parties "have the protection always accorded to them by the courts which limit burdensome subpoenas, restrict them to relevant material and refuse to permit unwarranted 'searches and seizures" and "interventions which delay government action at the investigative

stage" should not be permitted "unless the interest asserted is direct and immediate". *Foster* v. *United States*, 265 F. 2d 183, 189 (C.A. 2d), certiorari denied, 360 US 912. Petitioners did not show any such "direct and immediate" interest.

2. There is no conflict in decisions. *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731 (C.A. 9th) is distinguishable. There, the government instituted an enforcement proceeding to obtain third party records and it was held that the third party could invoke the predecessor provisions of Section 7605(b) to prevent the government from obtaining an order requiring the production of records which were shown, to the court's satisfaction, to be unnecessary to any investigation. Here the taxpayer-petitioners and not the affected third parties moved to quash summonses seeking third party testimony and records, and the record does not contain allegations of facts showing that the investigation is unnecessary.[3]

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[3] Even on its own limited ground *Martin* v. *Chandis Securities* is out of harmony with this Court's more recent pronouncements of the minimal showing required to enforce administrative subpoenas. See *Civil Aeronautics Board* v. *Hermann*, 353 U.S. 322; *United States* v. *Morton Salt Co.*, 338 U.S. 632; *Oklahoma Press Pub. Co.* v. *Walling*, 327 U.S. 186, 208. See also *Foster* v. *United States*, 265 F. 2d 183, 186 (C.A. 2d) and Judge Pope's dissent in *Local 174, Etc.* v. *United States*, 240 F. 2d 387, 393, 395 (C.A. 9th).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1962.